Risk Management for Private Equity

AIFMD and SIF law - A new challenge

A fresh approach tailored to your challenges

The latest economic crisis has highlighted the need to improve the Risk Management processes and structures.

In that context, there are no "one size fits all" approach or set of general risk factors that can be used. Therefore, Risk Managers and Board of Directors of Management Companies will have to thoroughly understand their exposures and monitor them adequately.

Legal context	*Who will be impacted?*
AIFMD	
The Alternative Investment Fund Manager Directive (AIFMD) entered into force on the 1st of July 2011. The ultimate deadline for EU Member States to transpose the AIFMD into their national law is July 2013. On 19 December 2012 the European Commission published its adopted level 2 Delegated Regulation (Level 2) for the AIFMD.	The AIFMD will apply to all AIFMs established in the EU managing AIFs, irrespective of the AIFs domicile, and to the non EU AIFMs managing EU AIF or non-EU AIF marketed to EU investors. Although level of asset under management needs to be considered, the target audience is particularly wide.
SIF	
The new article 42bis of the updated SIF Law now requires SIFs to implement a Risk Management policy and appropriate systems to detect, measure, manage and monitor the risks associated with the portfolio positions and their contribution to overall risk profile of the portfolio.	All SIF's will be required to cope with this new requirement regardless of their investments and level of Assets Under Management.

Risk Management impacts

Areas of impacts

Governance	Risk measurement	Disclosure
• An independent Risk Management function must be created • Remuneration policy should be consistent with effective Risk Management • A clear Risk Management process needs to be implemented	• Each AIF's risk profile needs to be defined • All risks associated with AIF strategies need to be measured and monitored • The importance of having a strong liquidity risk management process is particularly stressed • Leverage levels as well as methods used need to be clearly identified and monitored	• Transparency being one of the key overall objectives of the Directive , the level of quantitative and qualitative disclosures to authorities and investors is unprecedented.

Risk Management for Private Equity – A different approach

Applying conventional Risk Management procedures and techniques in Private Equity is not possible and adapting them to this industry can be quite challenging.

Risk Management in the Private Equity industry does not solely concern the portfolio but also risks inherent to the structure and those embedded in the full investment value chain. In developing the Risk Management framework, best practice linked to the industry (e.g. EVCA) will need to be considered.

How to approach Risk Management in Private Equity?

Investment value chain

Screen

Structuring → Sourcing → Preinvestment analysis → Preliminary internal Go / No-Go

- Understand and define investor risk appetite and include it throughout the investment management process
- Identify and maintain a reliable sourcing network
- Identify all risk exposures related to the selected project and ensure its adequacy with portfolio management
- Ability to gather the IC within a reasonable timeframe
- Quality of the first valuation and short due diligence

Acquire

Due Diligence → Investment Approval → Fund disbursement

- Partners selection for due diligence
- Quantification of main risk indicators:
  - Direct funds: Portfolio Company risk (e.g. related markets evolution, technology/products, leverage levels, evolution of interests rates, litigation, regulatory changes), industry/geographical concentration, valuation risk, funding risk, etc.
  - Fund of Funds (e.g. funding, liquidity, valuation, interest and financing, currency, concentration, quality of management and underlying risk management)

Monitor

Portfolio Company management → Portfolio Management → Finance and fund management

- Establish acceptable risk limits
- Measure and monitor identified risks
- Conduct periodic stress tests and scenario analysis

Exit

Selection → Approval and negotiations → Liquidation/full exit

- Exit strategy
- Partners in negotiation
- Time required for sale
- Fund's life and opportunity for sale

Fund structure

- Quality of related parties (e.g. investors, banks, portfolio companies) and its evolution
- Direct or Fund of Funds
- Taxation
- Adequacy of people profiles
- Level of participation (controlling, non controlling)
- Main strategy (e.g. Buyout, venture, mezzanine, growth, secondary, co.-invest)
- Governance

How we can help

Our team of experienced risk professionals has developed a library of best practices in Risk Management for Private Equity funds including fund of funds and can help you meet regulatory requirements through:

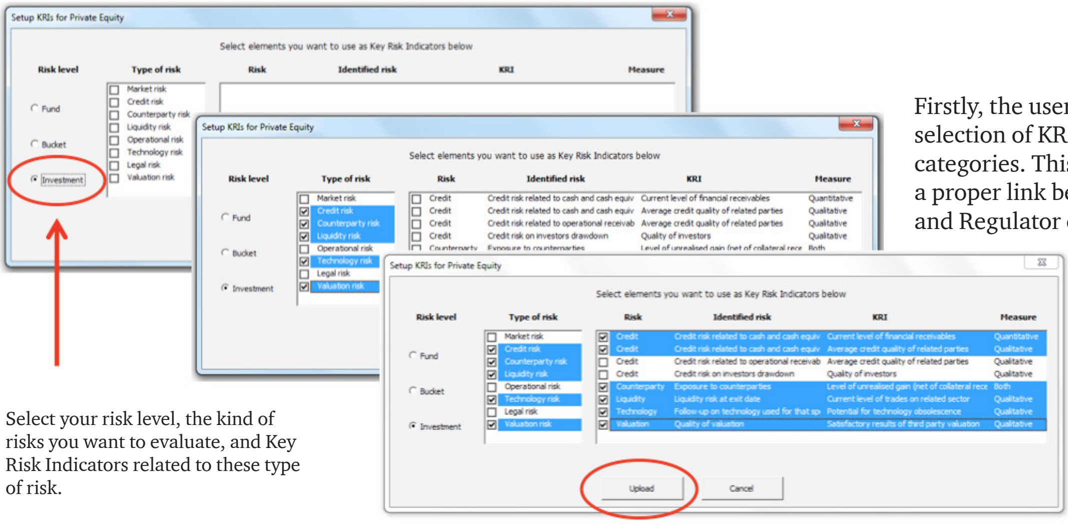
- **Diagnostic:** Assessing the quality of Risk Management process;
- **Risk appetite:** Defining and challenging company's risk appetite using our dedicated framework;
- **Risk profiling:** detailed analysis of risk exposures to determine the Key Risk Indicators that will need to be monitored;
- **Assistance in implementing Risk Management standards:** define and implement Key Risk Indicators, create related dashboards, Stress testing, etc.
- **Set-up of Risk Management Function** compliant with AIFMD and SIF law;
- **Assistance to meet coming regulatory requirements;**
- **Trainings:** Dedicated training sessions through our PwC Academy.

Definition of Key Risk Indicators (KRI) and risk dashboards

Setting-up an appropriate Risk monitoring approach can be a challenging task.

In order to support you in an efficient manner, in collaboration with our Private Equity and IT experts, the Risk Management team has developed a dedicated tool which involves two key aspects.

Use of a Key Risk Indicators database

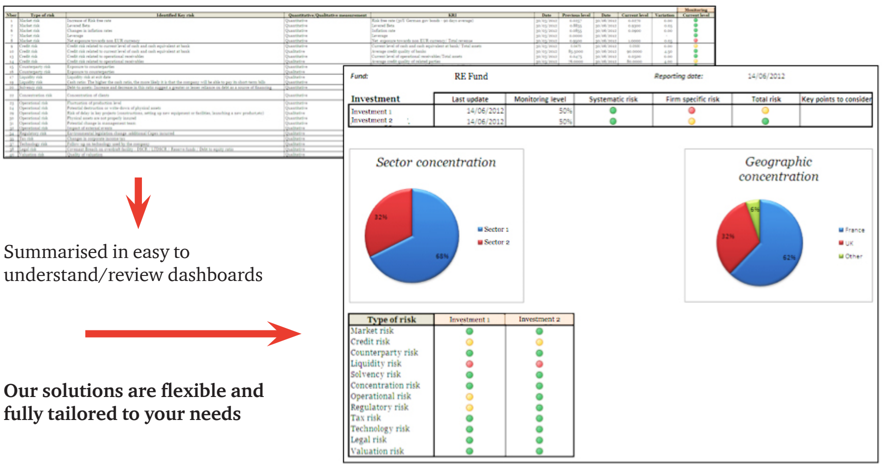


Select your risk level, the kind of risks you want to evaluate, and Key Risk Indicators related to these type of risk.

Then, upload your selected KRIs to a dedicated tool

Firstly, the user has access to a dynamic selection of KRIs that are allocated by Risk categories. This will guarantee from inception a proper link between Risk Management tasks and Regulator expectations.

Detailed Risk assessment



Summarised in easy to understand/review dashboards

Our solutions are flexible and fully tailored to your needs

Secondly, once the selection of KRI is performed, detailed reporting analysis will be structured. By properly filling all the results of the KRI measurements and also defining the related limits, the dashboards summarizing in a user friendly style the Risk monitoring results will be automatically generated.

Why PwC Luxembourg?

Our specialist team members have gained a strong expertise as consultants and through their experience within the Private Equity industry. As a result, we are able to quickly understand your concerns. Our solution is proportionate to the scale, diversity and complexity of your activities, so it is really tailored and sound.

PwC Luxembourg (www.pwc.lu) is the largest professional services firm in Luxembourg with 2,200 people employed from 57 different countries. It provides audit, tax and advisory services including management consulting, transaction, financing and regulatory advice to a wide variety of clients from local and middle market entrepreneurs to large multinational companies operating from Luxembourg and the Greater Region. It helps its clients create value they are looking for by giving comfort to the capital markets and providing advice through an industry focused approach.

The global PwC network is the largest provider of professional services in audit, tax and advisory. We're a network of independent firms in 158 countries and employ more than 180,000 people. Tell us what matters to you and find out more by visiting us at www.pwc.com and www.pwc.lu.

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